

Multistate Tax Commission



**Multistate Tax Commission
Full Uniformity Committee
Holiday Inn by the Bay -- San Diego, CA
March 15 and March 16, 2004
Minutes of Meeting**

I. Welcome and Call to Order

The Chair called the meeting to order. The following individuals attended one or more of the meetings of the Sales/Use Tax Subcommittee, the Income/Franchise Subcommittee, or the Full Uniformity Committee:

Name	State or Affiliation	Name	State or Affiliation
Robynn Wilson	AK	Tino Barraza	TX
Mike Brownell	CA FTB	Frank Hales	UT
Joe Thomas	CT	Rod Marrelli	UT
Marshall Stranburg	FL	Bob Heller	WA
Dick McFarland	ID	Rick DeBano	WI
Joe Randall	ID	Andrew Glancy	WV
Ted Spangler	ID	Rick Scheer	WY
Jennifer Hays	KY	Private Sector	
Dale Vettel	MI	Diann L. Smith	COST
Larry Wilkie	MN	Arthur Rosen	McDermott, Will, and Emery
John Feldmann	MO	William Weissman	Morrison & Foerster, LLP
Gene Walborn	MT	Larry Makowski	Wheels, Inc.
Lennie Collins	NC	MTC Staff and Consultants	
Blane Braunberger	ND	Dan Bucks	
Donnita Wald	ND	René Blocker	
Mary Loftsgard	ND	Frank Katz	
Charlie Rhulinger	OH	Shirley Sicilian	
Jeffrey Sherman	OH	Ken Beier	
Eric Smith	OR	Roxanne Bland	
Janielle Lipscomb	OR	Elliott Dubin	
Bret Afdahl	SD	Cathy Felix	
Bruce Christensen	SD	Les Koenig	
Wyla Posey	TN AG	Rick Pomp	Univ. of Conn.
Adina Christian	TX		

II. Approval of Minutes of October 2003 Meeting

Action on Minutes of the October 2003 meeting was deferred until the Minutes are available

Kentucky moved that the minutes of the November 24th meeting of the Income and Franchise Tax Subcommittee be approved. Connecticut seconded the motion. The motion was approved unanimously. Montana moved that the minutes of the December 17th meeting of the Income and Franchise Tax Subcommittee be approved. Connecticut seconded the motion. The motion was approved unanimously.

III. Public Comment Period

None.

IV. Executive Director's Report

The Executive Director informed the Committee that the liaison from the Executive Committee will be designated.

The Executive Director then exhorted the members of the Committee to attend the Annual Meeting, which will be held the last week of July in Mystic, CT. David Cay Johnston, *New York Times* reporter and noted author will be the key note speaker.

Compliance Initiative

The Executive Director explained the work of the three compliance work groups: Sales and Use Tax; Corporate Income Tax Sheltering Work Group; and the Pass-Through Entity Work Group. He noted that the compliance problems for the states are extremely large – approximately \$30 -- \$50 billion in tax revenue that is legally owed to the states is uncollected. The Executive Director went over the press coverage and increasing public knowledge about how large companies are shifting income from states in which the income is earned to states with no taxes on the income. He urged the Committee members to inform their administrators about the work of the Compliance Initiative.

Federal Legislation Affecting States

- Internet Legislation: The Executive Director informed the Committee that the major state and local interest groups are backing S2084, which extends the Internet Tax Moratorium but does not preempt the states from imposing property, income, or taxes on Internet access services, and is limited in duration. The state and local interest groups were instrumental in delaying passage of H.R. 49 and the original S150 bills that were much more inimical to state revenue systems. He noted that Congress is busy with Federal budget matters and with the upcoming elections so it is possible that no legislation will be passed this year.

- Business Activity Tax Restrictions: The House Judiciary Committee may hold hearings on H.R. 3220, which was introduced in the fall of 2003. MTC is working to defeat this bill.
- Other Federal Legislation: S882 expands mutual offsetting refunds for state taxes.
- Senators Levin (MI) and Coleman (MN) introduced bills that would impose penalties for use of abusive tax shelters.
- Streamlined Sale Tax: Because Congress is busy with budget matters and the elections, no action is likely this year. There are still some issues to be resolved. The top objective is to have the SSTP running by January 1, 2005.

V. Income and Franchise Tax Segment

A. Combined Reporting Statutes

1. Review of California Guide on Combined Reporting: Michael Brownell, California Franchise Tax Board

Michael Brownell of the California Franchise Tax Board (CA FTB) gave a thorough explanation of how California's combined reporting system operates. The main topics discussed by Mr. Brownell were:

- *Holding Companies*: Mr. Brownell explained that the combined reporting system mitigated the problem that separate entity reporting states face regarding intercompany payments of royalties, interest and dividends.
- *"Waters Edge"*: Worldwide combined reporting is the default method of reporting in CA. Companies can opt for "waters edge" treatment if that is to their benefit. However, Mr. Brownell noted that CA can enforce "waters edge" treatment if the average of the worldwide apportionment factors in the U.S. exceeds 20 percent.
- *Dividends*: Mr. Brownell noted that the dividend received deduction is problematic for states because companies must treat foreign and domestic dividends in the identical manner for state income tax purposes.
- Treatment of constituent companies in the combined report: Each entity is treated separately to account for wholly intrastate income and non-business income or loss. It is necessary to treat each entity separately to account for intrastate income and non-business income.

Mr. Brownell also discussed California treatment of:

- Deferred income – uses federal government method to account for deferred income.
- Fiscalization to account for the possible differences in fiscal years for some of the entities in the combined group.
- California can combine "S" corporations and "C" corporations to mitigate transfer pricing problems.

- Net Operating Losses (NOL's) are determined on an entity-by-entity basis.
- Use of Federal rules for intercompany transactions.
- CA treatment of capital gains and losses
- CA allows credits to be assigned to any or all companies in the unitary group – not necessarily the unit that incurs the costs.

Shirley Sicilian, MTC Deputy General Counsel, suggested that the next step for the Committee was to start drafting model statutes. Some members of the Committee raised the question of whether combined reporting should be voluntary or mandatory and whether there may be short-term loss in revenue as a result. Ted Spangler (ID), Chair of the Uniformity Committee, outlined the history of why the Uniformity Committee became involved with combined reporting – to recommend to separate entity states for adoption. The states can share information to reduce any short-term losses that might result from adoption of combined reporting.

► Motions: The following Motions were made to provide staff with preliminary guidance for a first draft statute and rule for continued Subcommittee consideration:

Idaho moved that the first draft of the combined reporting rule should indicate combined reporting is mandatory for all unitary businesses; and that all unitary entities should be included in the combined report. California seconded the motion. The motion was approved unanimously.

Idaho moved that the first draft reflect all members of a unitary group be allowed to file a single return with a “key” corporation that acts as a guarantor of each taxpayer’s liability. California seconded the motion. The motion was carried unanimously.

Ohio moved that the first draft reflect that each member of a unitary group should determine its own income as if it were unconnected to the other members. California seconded the motion. The motion was carried unanimously.

Idaho moved that for the first draft, the California method of “fiscalization” be adopted if members have different fiscal years. California seconded the motion. The motion was carried unanimously.

California moved that for the first draft if a member leaves the unitary group during the its fiscal year, the combined report will include that member’s income during the interim fiscal year end closing if pro rating the income causes material misstatement of the unitary group’s income. Idaho seconded the motion. The motion was carried unanimously.

Idaho moved that for the first draft net operating losses are post-apportioned to each member. California seconded the motion. The motion was carried unanimously.

Idaho moved that for the first draft business and non-business capital gains are included in the unitary group’s income, consistent with MTC apportionment policies. No vote was recorded.

Idaho moved that for the first draft only the member of the unitary group that incurs a credit may take the credit, unless this rule is over ridden by the legislature. Ohio seconded the motion. The motion was carried unanimously.

Idaho moved that for the first draft worldwide combined reporting would be recommended as the optimal system of combine reporting but an alternative recommendation would be “water’s edge” reporting but would include the income in OECD recognized tax havens. California seconded the motion. The motion passed unanimously.

Idaho moved the discussion of the treatment of charitable expenses be deferred. Ohio seconded the motion. The motion passed unanimously.

Idaho moved that for the first draft the treatment of partnership income in the unitary group be deferred; and that three teleconferences would be held to discuss: 1) limited liability corporations; 2) personal trusts; and 3) rule –making. Oregon seconded the motion. The motion passed unanimously.

Idaho moved that for the first draft unitary entities that are not corporate income taxpayers should be included in the combined report when a proper apportionment formula can be obtained. Ohio seconded the motion. The motion passed unanimously.

B. Telecommunications Apportionment

Shirley Sicilian, MTC Deputy General Council discussed the initial draft of the proposed apportionment regulations and the changes that were made at the February conference call. It was noted that the definition of telecommunications contained in this draft does not conform to the Federal Communications Commission definition. Certain changes were made to the draft; e.g., the text “in the business of” in section (1) was eliminated to accommodate the suggestion that the proposed regulations apply to all businesses that provide telecommunication services. Other changes to the draft clarified the meaning of the text.

Diann Smith of COST informed the Committee that COST and the telecommunication industry are working on a White Paper that will be available by the end of June which will contain the industry comments on the proposal. Steve Kranz of COST is heading this project. There will be a teleconference of MTC Committee members, COST and representatives of the telecommunication industry after MTC receives the White Paper.

VI. Sales Tax Segment

A. Sales and Use Tax Priority:

Roxanne Bland, MTC Counsel, reviewed Draft # 15 of the Leasing Transactions portion of the Sales and Use Tax Priority Project. Ms. Bland informed the Committee that there were only two items left for review:

- The second sentence in Section C1 – Priority Rule #1 was eliminated because it is extraneous.
- The last sentence in Section C2 pertains to the credit to be given to the lessee, by State B, when the lessee moves the leased property from State A (the site of the original lease) to State B. In this lease, the purchaser (lessor) in State A pays the tax on the property to be leased and passes the tax on to the lessee (State A taxes the entire lease up front). If the subsequent state (State B) taxes both the purchase of the leased property and the stream of lease payments, the lessee in State B is entitled to a credit from State B if the original lessor shows documents to the tax department in State B showing that the tax was paid on the purchase and the tax was passed on the lessee.

Texas moved that the revised draft of the proposed rule be moved to the Executive Committee for approval. Ohio seconded the motion and was the only state to oppose the motion. The motion will be sent to the Executive Committee.

B. The Internet Tax Freedom Act Extension:

Frank Katz, MTC General Counsel, informed the Committee that the House passed H.R. 49 and that S. 150 passed the Commerce Committee. The Managers' Amendment to S.150 limited the scope of the preemption of telecommunications taxes to transactions taxes. S2084, which limits the time frame of the extension, retains the "grandfather" clause, and is limited to transactions taxes, contains unclear language on the unbundling of Internet access from other telecommunications services.

Mr. Katz will provide, by email, the Committee with the Congressional Budget Office documents on broadband and a *State Tax Notes* article by Professors Charles McLure and Walter Hellerstein on Federal preemption of state taxes.

C. Streamlined Sales Tax Project

Roxanne Bland outlined the progress of the Streamlined Sales Tax Project (SSTP) and the plans for future meetings. She informed the Committee that the SSTP one-stop registration system will be built by the MTC as part of MTC's more inclusive one-stop registration system.

VII. Proposals for New Projects

- *Taxation of On-Line Hotel Reservations*

Marshall Stranburg, FL DOR, described Florida's efforts to reform the system of taxation; and, will prepare a one paragraph statement of the problem for the Committee. Briefly, Mr. Stranburg stated that there are two options:

- a. The dot com hotel reservation company either registers or remits the tax collected on the full price that they charge the customer; or, the hotel remits the full price charged the customer.

- b. The dot com reservation registers and remits the tax on the mark up between the full price charged to the customer and the price the dot com pays to the hotel (base price). The hotel pays the tax on the base price.

Mr. Stranburg informed the Committee that nexus problems and others complicate the situation. However, the new contracts between hotels and the dot coms which use proprietary sites may limit the problems.

VIII. New Business

The Committee voted on the site for March meeting. There were 16 votes for Tampa/St. Petersburg in conjunction with the FTA March meeting, but not in between Passover and Easter. There were 16 votes to keep the meeting in San Diego at a time to be determined. Charleston, SC received 8 votes.

IX. Adjournment

Florida moved that the meeting be adjourned. Montana seconded the motion. The meeting was adjourned at 4:48 P.M. PST.